

Motor Fuel Tax Indexing In Wisconsin

*Creating a Stable Revenue Base and
Continuous Revenue Growth to Maintain and then Increase
Long-Term Transportation Investment*

Subcommittee on Highways and Transit
Committee on Transportation and Infrastructure
U.S. House of Representatives
July 16, 2002

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Thank you, Mr. Chairman. I am Tom Walker. I appreciate the opportunity to share with you this morning the very positive contribution to Wisconsin transportation over nearly 20 years from our adoption of motor fuel tax indexing. From several positions in both the public and private sectors, I was privileged to play a key role in conceptualizing indexing, advocating its passage, defending it from misguided concerns, and enacting several changes to improve it.

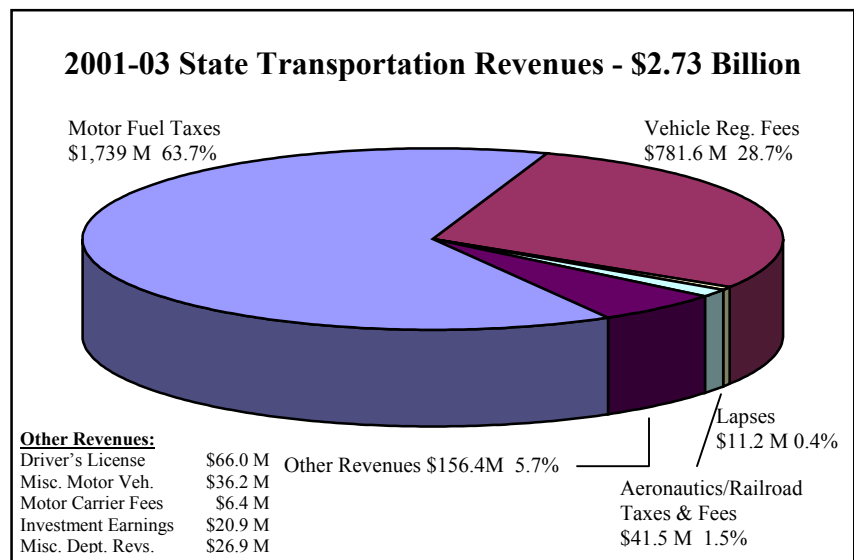
Overview: Motor Fuel Tax Indexing

Wisconsin has historically relied heavily on revenues from its motor fuel tax to fund a variety of transportation investments. Since creation of the state's segregated Transportation Fund in 1978, motor fuel tax dollars have accounted for approximately 65% of state-generated transportation revenues. In fact, fuel taxes (28.1 cents/gallon as of April 1, 2002) and vehicle registration fees (\$45 annually for cars/light trucks) account for more than 90% of state user fees deposited into the fund that supports all transportation modes – an extremely narrow revenue base that is unique nationally.

The concept of indexing Wisconsin's motor fuel tax rates evolved during a period of high inflation and decreasing fuel consumption, a dangerous combination of factors in a state whose transportation funding base rests largely on motor fuel revenues. Implementation of motor fuel tax indexing in the mid-1980s stabilized this critically important revenue source and maintained the

purchasing power of those state dollars through 1997. Combined with the increased federal commitment to transportation in ISTEA and TEA-21 and a key 1997 change in its formula, indexing has allowed Wisconsin to develop comprehensive, long-term plans and financial commitments to improve its transportation system.

The initial funding stability and later, sustained fuel tax revenue growth created by indexed motor fuel tax rates provided Wisconsin's primary transportation revenue source a similar inflationary adjustment that other General Fund taxes automatically produce without legislated increases in their rates.



These fuel tax increases almost certainly would not have occurred if our state Legislature had been required to vote on “increasing fuel tax rates” during each biennial budget. By comparison to Wisconsin, both Iowa and Minnesota’s fuel tax rates have been stuck at 20 cents per gallon for more than a decade, with major negative consequences on the highway infrastructure in those states. The issue is simply too hot, politically.

Background

Wisconsin’s fuel tax was created in 1925 at a rate of 2 cents per gallon. Since a segregated highway fund was not created until 1945, the revenues generated from the fuel tax were initially deposited in the state’s General Fund. However, these receipts were appropriated for the purpose of developing and maintaining highways. In fact, the stated intent of establishing the new tax was to transfer the source of funding for highway programs from the general taxpayer to the highway user.

Increases in the state fuel tax rate occurred very sporadically between 1925 and 1980. Motor fuel consumption grew at an annual rate of approximately 7% from the mid-1960s to early 1970s, well above the rate of inflation. This created a predictable source of revenue growth that allowed Wisconsin to keep pace with highway needs. Even though the motor fuel tax rate (7 cents/gallon) did not change during this period, increased fuel consumption provided revenue growth – until 1973.

Wisconsin’s period of disinvestment

In the mid-1970s the supply and price of fuel were significantly impacted by international events, prompting the country to impose Corporate Average Fuel Economy (CAFE) standards on its vehicle fleet. As a result of greater fuel efficiency and public reaction to price spikes, fuel consumption remained relatively flat while the nation struggled with double-digit inflation. Fuel consumption began to increase again during the last half of the 1970s before falling for four consecutive years in the early 1980s:

| Taxable Gallons of Motor Fuel & Special Fuel | | |
|---|-----------------------|------------------------|
| <u>Fiscal Year*</u> | <u>Gallons</u> | <u>% Change</u> |
| 1978-79 | 2,692,913,114 | 2.5% |
| 1979-80 | 2,532,206,865 | -6.0% |
| 1980-81 | 2,394,755,228 | -5.4% |
| 1981-82 | 2,301,789,016 | -3.9% |
| 1982-83 | 2,259,813,144 | -1.8% |
| 1983-84 | 2,353,887,309 | 4.2% |
| 1984-85 | 2,343,792,339 | -0.4% |
| 1985-86 | 2,363,866,207 | 0.9% |

* Wisconsin’s fiscal year is July 1 – June 30.

When combined with the significant inflation of the 1970s and early 1980s, the reduced fuel consumption resulted in a major reduction in the purchasing power of the main component of Wisconsin's transportation revenue base. While inflation caused the price of goods to skyrocket triple between 1966 and 1980, there were no corresponding increases in highway user fees. As a consequence, major portions of the state transportation system began to fall into disrepair. Resources were not adequate to resurface the large percentage of roads originally built in the 1960s; capacity improvements were non-existent and an alarming number of state and local bridges were either structurally deficient or functionally obsolete.

The state Legislature responded to the growing infrastructure crisis by enacting a series of increases in the motor fuel tax rate – from 7 cents a gallon in 1980 to 16 cents a gallon by 1984. The 9-cent increase in the fuel tax over a four-year period surpassed the 7-cent increase that had occurred over the previous 55 years. Suddenly, fuel tax rates had become a persistent legislative issue that forced tough votes, nearly always in a crisis environment, just to maintain funding for existing transportation programs. Political leaders began to realize that indexing motor fuel tax rates was the only way to provide the type of constant-dollar revenue stream that was naturally generated by income and sales taxes.

History of Wisconsin Fuel Tax Rate

| Year | Tax Rate Per Gallon | Type of Rate Change |
|----------------------|------------------------|------------------------|
| 1925 | 2.0 | Statutory |
| 1931 | 4.0 | Statutory |
| 1955 | 6.0 | Statutory |
| 1966 | 7.0 | Statutory |
| 1980 | 9.0 | Statutory |
| 1981 | 13.0 | Statutory |
| 1983 | 15.0 | Statutory |
| 1984 | 16.0 | Statutory |
| 1985 | 16.5 | Index Adjustment |
| 1986 | 17.5 | Index Adjustment |
| 1987 (April 1) | 18.0 | Index Adjustment |
| 1987 (Aug. 1) | 20.0 | Statutory |
| 1988 | 20.9 | Index Adjustment |
| 1989 | 20.8 | Index Adjustment |
| 1990 | 21.5 | Index Adjustment |
| 1991 | 22.2 | Index Adjustment |
| 1993 | 23.2 | Index Adjustment |
| 1994 | 23.1 | Index Adjustment |
| 1995 | 23.4 | Index Adjustment |
| 1996 | 23.7 | Index Adjustment |
| 1997 (April 1) | 23.8 | Index Adjustment |
| 1997 (Nov. 1) | 24.8 | Statutory |
| 1998 | 25.4 | Index Adjustment |
| 1999 | 25.8 | Index Adjustment |
| 2000 | 26.4 | Index Adjustment |
| 2001 | 27.3 | Index Adjustment |
| 2002 | 28.1 | Index Adjustment |

Note: The Legislature suspended indexing in 1992, but provided two years of adjustment in 1993.

Democratic Governor implements indexing

In 1983, Democratic Gov. Anthony Earl seized upon a recommendation of a Blue Ribbon Commission on Long-Range Transportation Financing, created by his Republican predecessor, and proposed a system of motor fuel tax indexing in Wisconsin. The initiative was viewed as a long-term solution to the state's transportation funding needs that would prevent the dramatic declines in the purchasing power of revenues that resulted in a significant deterioration of the system in the 1970s and early 1980s. It would enable current programs to keep even with inflation and declining fuel consumption, while still subjecting proposals for real program growth to legislative debate. The state's diverse transportation interest groups – most of whose programs rely on fuel tax revenues – largely supported the measure and it was passed by a Democratic Legislature.

According to Chapter 78.015 of the Wisconsin State Statutes, indexing became effective on April 1, 1985:

78.015 Annual adjustment of tax rate. (1) Beginning in 1985, on or before April 1 the department shall recompute and publish the rate for the tax imposed under s. 78.01 (1) and the rate under s. 78.14. The new rate per gallon shall be calculated by multiplying the rate in effect at the time of the calculation by an amount obtained by multiplying the amount under sub. (2) by the amount under sub. (3).

(2) Divide the highway maintenance cost index, as computed by the federal department of transportation, federal highway administration, for the year prior to the year during which the calculation is made by that index for the year that is 2 years prior to the year during which the calculation is made.

(3) Divide the number of gallons of motor fuel and special fuel sold in this state, as estimated by the department, during the year 2 years prior to the year during which the calculation is made minus any shrinkage allowed by the department by the number obtained by subtracting from the number of gallons of motor fuel and special fuel sold in this state, as estimated by the department, during the year prior to the year during which the calculation is made minus any shrinkage allowed by the department.

(4) The rate calculated under this section shall be rounded to the nearest 0.1 cent.

Initial formula included two factors

As originally approved and signed into law, indexing was intended to maintain the buying power of motor fuel revenues through two factors. A road-related Highway Maintenance Cost Index*, calculated by the Federal Highway Administration, was used to determine the annual inflationary adjustment to the fuel tax rate. A separate fuel consumption factor was used to counterbalance the cost index so that decreased fuel usage would create upward pressure on the annual adjustment. These two factors, explained in the formula below, helped maintain the purchasing power of fuel tax revenues:

| Original Motor Fuel Indexing Formula <i>Steps used to calculate Wisconsin's 1991 motor fuel tax rate</i> | | | |
|--|--|---|--|
| Step #1: Divide 1990 Hwy. Cost Index* by 1989 Hwy. Cost Index for Inflation Factor | <div> '90 Hwy. Cost Index <u>228.23</u> 219.09 = 1.042 '89 Hwy. Cost Index </div> | Step #2: Divide 1989 Fuel Consumption by 1990 Consumption for Consumption Factor | <div> '89 Fuel Consumption <u>2.523 Billion</u> 2.542 Billion = .993 '90 Fuel Consumption </div> |
| Step #3: Multiply Inflation Factor by Consumption Factor for Adjustment Factor | <div> Inflation: 1.042 X <u>Consumption: .993</u> Adjustment: 1.034706 </div> | Step #4: Multiply 1990 fuel tax rate by Adjustment Factor | <div> '90 Fuel Tax (per gallon): 21.5 X <u>Adjustment Factor: 1.034706</u> '91 Fuel Tax (per gallon): 22.2 </div> |

* The Highway Maintenance Cost Index was replaced in 1991 by the Consumer Price Index-Urban because FHWA was no longer committed to providing annual updates to accommodate Wisconsin's April 1 indexing adjustment schedule.

Republican Governor's veto maintains indexing

Rep. Tommy G. Thompson was among the rural Republicans whose support was critical in the implementation of indexing in 1983. Economic development opportunities created by increased transportation investment became a cornerstone of his 1986 successful gubernatorial campaign. That resolve was quickly tested in his first state budget as governor when a Democratic-controlled Legislature approved his request for a 2-cent increase in the base motor fuel tax rate, but also sought the repeal of indexing. Gov. Thompson used his line-item veto power to strike the repeal of indexing (while retaining the 2-cent increase in the base tax rate), defeating the only serious challenge to indexing in Wisconsin since its inception.

Throughout his administration, Gov. Thompson continued to support indexing not only as a way to maintain, but also increase, the buying power of fuel tax revenues to keep pace with unprecedented travel demands (vehicle miles of travel in Wisconsin grew 29% during the 1990s) fueled by a robust economy.

During the same period, Gov. Thompson lobbied the Legislature to increase other state funding to address the significant backlog of highway capacity needs. In 1991, he proposed and the Legislature approved increased vehicle registration fees to fund the governor's Corridors 2020 highway and economic development initiative. This network of two- and multi-lane highways connecting regions of the state with each other and national markets would later become a model for development of the National Highway System.

Without indexing, those increases in vehicle registration fees would have merely replaced some of the lost buying power of the fuel tax, due to buying power erosion from inflation.

In 1997, he followed a recommendation of his Transportation Finance Study Committee to remove from the indexing formula the fuel consumption factor, which limited increases in the fuel tax rate as fuel consumption increased in the 1990s. This, in essence, shifted the focus of indexing from the fuel tax yield to the fuel tax rate. As a result, constant dollar fuel tax revenues now grow and help provide some additional funding to meet the needs created by increased traffic levels.

The governor also pushed for increased transportation investment in 1997 through a 1-cent increase in the base motor fuel tax and modest increases in vehicle registration fees.

Bi-partisan support for motor fuel tax indexing

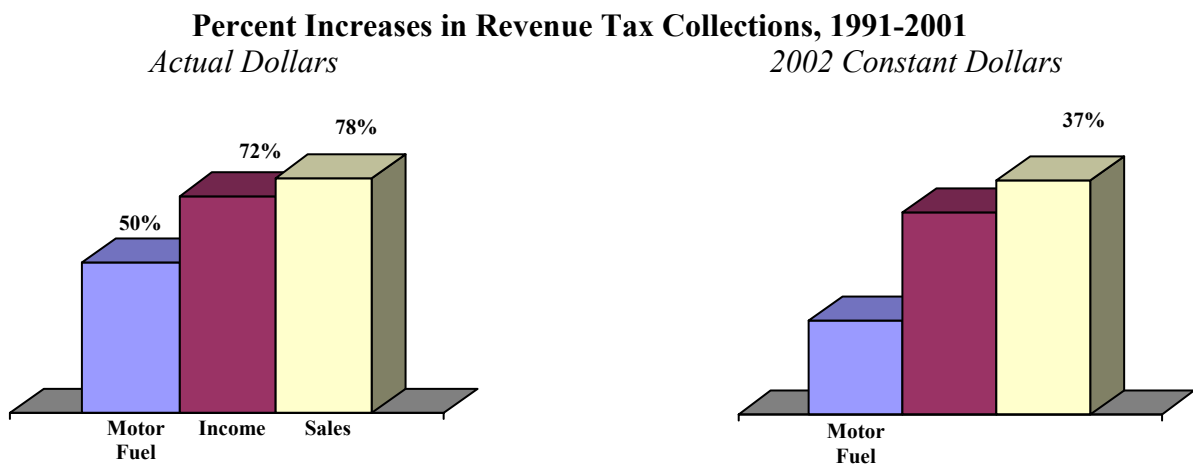
There continues to be strong, bipartisan support for motor fuel tax indexing in Wisconsin's Legislature. Opposition comes mainly from a small group of legislators that philosophically objects to additional highway lanes and sees transportation revenue growth as allowing that to continue. However, construction of additional highway capacity represents less than 10% of annual state transportation spending, and most legislative attempts to repeal indexing are seldom afforded a committee hearing.

An annual debate on indexing usually focuses on whether motor fuel tax rates should increase without a vote of the Legislature. Neither sales nor income tax rates are increased without political scrutiny and it is undemocratic to provide automatic increases in fuel tax revenues, critics contend.

However, income and sales tax revenues are generated much differently than fuel tax revenues. Income and sales tax revenues grow naturally (*at least*) at the rate of inflation because they are tied to earnings and the price of goods and services. In a strong economy, this natural growth that occurs without a legislative vote can be used to expand state investments. By comparison, fixed fees such as the motor fuel tax must be regularly increased or the programs they fund will stagnate.

In Wisconsin during the 1990s, income and sales tax revenues grew 72% and 78%, respectively, without any changes in the tax rate or a vote of the Legislature. In fact, the Legislature voted to decrease income tax rates during the decade. During the same period, motor fuel tax revenues grew only 50% despite repeated annual increases in the fuel tax rate due to indexing and a one-cent per gallon increase in the base fuel tax rate in 1997.

Which tax is the automatic one? Clearly, fuel tax indexing has a much smaller impact on taxpayers than the internal tax growth generated by sales and income taxes. Without doubt, fuel tax indexing is clearly not “out-of-control” taxation.



That 15% constant dollar revenue increase might not seem like much, but it should be compared to the 30% decrease in buying power experienced in states without indexing or legislated fuel tax increases. That's a gap of 45%.

It's critical to recall that when indexing included a fuel consumption factor, constant dollar growth could not occur. The goal was simply to maintain buying power from the motor fuel tax. However, starting with the 1998 adjustment, the goal was constant dollar growth. The entire 15% in real growth from 1991 to 2001 occurred in the last three and one-quarter years. Indexing the fuel tax rate just to inflation has dramatically proven itself!

Benefits of funding predictability

It is this funding stability that has allowed Wisconsin to cost-effectively manage its transportation system over multiple years. With its base secure in an inflation-adjusted funding stream, Wisconsin has been able to avoid the additional costs that result from deferred projects and has developed an effective performance-based pavement and bridge management systems that choose optimal investment at the right time.

Coupled with a significant increase in the federal government's commitment to transportation through ISTEA and TEA-21, the stable revenue growth created by motor fuel tax indexing has helped Wisconsin considerably rebuild its transportation system. Since it was implemented in the mid-1980s, indexing has provided a consistent and dependable stream of revenue that allowed the state to address a significant backlog of highway and bridge deficiencies while continuing to rely almost solely on highway user fees to invest in all transportation modes.

Today's 28.2 cents per gallon motor fuel tax is 9.2 cents per gallon higher than it probably would be today, had Wisconsin relied only on legislated fuel taxes. From a taxpayer perspective, the annual increases have been modest, and no more than the rate of inflation. However, from a transportation system perspective, Wisconsin now has about \$300 million more in annual revenues to spend on transportation investment. To put that in perspective, in FY 2001, Wisconsin received \$549 million in Highway Account obligation authority, including RABA and High Priority Projects. Without doubt, indexing has been extremely successful.

Future Wisconsin transportation needs

Wisconsin's transportation system is now at a crossroads.

As with many other states, Wisconsin is facing a very large bill to replace and modernize aging and obsolete parts of its system. The 25-year cost to upgrade the SE Wisconsin Freeway System alone is estimated at about \$7 billion, while only \$46 million dollars a year is now available. Wisconsin needs to increase its annual investment in additional lane capacity on key routes by about 25%, as we face continuing travel growth, including a doubling of truck traffic. Additional funding will be needed to pay our match to develop a Midwest High Speed Rail System, and help the Madison and Milwaukee metro areas implement new fixed transit guideway proposals. Local roads, particularly those in urban areas, face major rehabilitation costs.

While indexing has and will continue to help, it is clear that major new sources of state funding will be required soon.

There has been serious discussion about indexing vehicle registration fees to maintain the purchasing power of these dollars, which represent the second-largest source of state transportation revenues. It has also been suggested that a second factor, measuring growth in travel, be added to the fuel tax indexing formula to better reflect the increased demands being placed on the system.

Other ideas are under discussion as well. These include a value-based registration fee and a phased transfer of the sales tax on motor vehicles from our state's General Fund to the Transportation Fund.

Meeting the challenge of funding a modern, multimodal transportation system in Wisconsin can't be achieved solely through state actions. But we must do our part.

Therefore, it is absolutely critical that our federal partner help as well, by making available significant additional funding for state and local highways, for high-speed rail, and for transit system development.

Recommendations for Congress

As Congress debates various financing options to meet the nation's transportation needs in the next reauthorization legislation, the Wisconsin Transportation Builders Association (WTBA) offers six recommendations for your consideration:

1. **Assess progress in meeting national needs by setting a long-term baseline target for transportation investment levels.** A number of organizations have already issued recommendations for transportation investments during the next bill. WTBA's national affiliate, the American Road and Transportation Builders Association, has evaluated US DOT system condition and performance data and concluded that no less than a \$50 billion annual highway program is needed. From ARTBA's and other proposals that will emerge over the next year, Congress should first agree on a baseline target for meeting the nation's annual transportation needs.
2. **Once a long-term baseline investment target has been established, it should be calculated in 2003 dollars and compared to projected FY 2002 funding, also in 2003 constant dollars.** Success should be measured in terms of constant dollar program growth toward the goal, not actual dollars. Using constant dollars will enable Congress to measure real growth possible for system improvements, over the life of the next bill.
3. **Index the federal motor fuel tax rate to the Consumer Price Index and credit the additional revenues toward meeting the long-term baseline investment target.** This will help ensure the federal government's primary means of funding transportation keeps pace with the effects of inflation and exceeds it to the extent that fuel usage grows.

4. **In addition to inflation, index the federal motor fuel tax to an index that measures vehicle miles of travel.** This mechanism, which would ensure that fuel tax revenues grow in proportion to the demands placed on the system by increased travel, will be especially significant as fuel cells and other energy sources begin to reduce the historic growth in fuel consumption.
5. **Make critical reforms to the Highway Trust Fund.** Balances should earn interest. The transfer of 2.5 cents per gallon of ethanol sales from the Highway Account to the General Fund should be terminated. The Highway Account of the Highway Trust Fund should be reimbursed dollar for dollar for revenues lost due to ethanol tax exemptions, OR, the exemptions should be terminated as unneeded if Congress passes a mandate for ethanol use in the energy bill.
6. **Bridge the remaining constant dollar gap between revised revenue forecasts from the above actions and the long-term baseline investment level with other increases in fees as necessary.** As in Wisconsin, indexing does not preclude a legislated increase in the base motor fuel tax rate.

Conclusion

Let me thank the Committee for its historic leadership role in meeting the nation's transportation needs and congratulate you for your diligence in thinking through what the next bill should contain and how it should be funded. We in Wisconsin are most appreciative of the strong federal program growth in the last two bills.

Stagnant federal fuel tax rates will severely limit what you can recommend. We believe that Wisconsin's political foresight by enacting indexing in 1983 has proven itself over nearly 20 years. We hope this committee will incorporate indexing provisions as one element of a revenue package in the next bill. I'm confident you will be pleased with the results.